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In the Supreme Court of the United States

WINN-DIXIE STORES, INC. AND SUBSIDIARIES,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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254

QUESTION PRESENTED

Whether expenses claimed in connection with a corporate-owned life insurance program may be deducted when that program lacked any economic substance or business purpose and was created solely for the purpose of generating tax deductions.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	9
Conclusion	20

TABLE OF AUTHORITIES

Cases:

ACM P'ship v. *Commissioner*, 157 F.3d 231 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999)	18
CM Holdings, Inc., In re, 254 B.R. 578 (D. Del. 2000), appeal pending, No. 00-3875 (3d Cir.)	15
Fabreeka Prods. Co. v. *Commissioner*, 294 F.2d 876 (1st Cir. 1961)	17
Frank Lyon Co. v. *United States*, 435 U.S. 561 (1978)	16, 17
Golsen v. *Commissioner*:	
54 T.C. 742 (1970)	15-16
54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971)	13
445 F.2d 895 (10th Cir.), cert. denied, 404 U.S. 940 (1971)	11
Gregory v. *Helvering*, 293 U.S. 465 (1935)	10
Horn v. *Commissioner*, 968 F.2d 1229 (D.C. Cir. 1992)	15
Karr v. *Commissioner*, 924 F.2d 1018 (11th Cir. 1991), cert. denied, 502 U.S. 1082 (1992)	11
Knetsch v. *United States*, 364 U.S. 361 (1960)	7, 8, 9, 10, 11, 12, 15, 16
Lee v. *Commissioner*, 155 F.3d 584 (2d Cir. 1998)	11
Maysteel Prods., Inc. v. *Commissioner*, 287 F.2d 429 (7th Cir. 1961)	17

Cases—Continued: Page

McLane v. *Commissioner*, 46 T.C. 140 (1966), aff'd, 377 F.2d 557 (9th Cir. 1967), cert. denied, 389 U.S. 1038 (1968) 7, 16
Pasternak v. *Commissioner*, 990 F.2d 893 (6th Cir. 1993) 11
Pierce v. *Commissioner*, 28 T.C.M. (CCH) 1 (1969) 16
Rogers v. *Lodge*, 458 U.S. 613 (1982) 19
Sacks v. *Commissioner*, 69 F.3d 982 (9th Cir. 1995) 17, 18
Salley v. *Commissioner*, 464 F.2d 479 (5th Cir. 1972) 11, 16
Shirar v. *Commissioner*, 916 F.2d 1414 (9th Cir. 1990) 11
Tiffany Fine Arts, Inc. v. *United States*, 469 U.S. 310 (1985) 19
UPS v. *Commissioner*, 254 F.3d 1014 (11th Cir. 2001) 18, 19
United States v. *Wexler*, 31 F.3d 117 (3d Cir. 1994), cert. denied, 513 U.S. 1190 (1995) 11
Weller v. *Commissioner*, 270 F.2d 294 (3d Cir. 1959), cert. denied, 364 U.S. 908 (1960) 13
Young v. *Commissioner*, 70 T.C.M. (CCH) 357 (1995) 15

Statutes:

Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 501, 110 Stat. 2090-2093 4
Internal Revenue Code (26 U.S.C.):
§ 162 (1994 & Supp. V 1999) 13
§ 162(a) (1994 & Supp. V 1999) 11
§ 163 (1994 & Supp. V 1999) 13
§ 163(a) 9, 10, 11, 12, 13, 15, 17
§ 264 (1994 & Supp. V 1999) 4, 6, 7, 11, 12, 13, 15
§ 264(a) (1994 & Supp. V 1999) 15

Statutes—Continued: Page

§ 264(a)(1)-(4) (1994 & Supp. V 1999) 13
§ 264(a)(3) (1994 & Supp. V 1999) 13, 14
§ 264(a)(4) (1994 & Supp. V 1999) 13
§ 264(a)(4) (1994) 2
§ 264(c)(1) (1994 & Supp. V 1999) 14
§ 7702 13

Miscellaneous:

Department of Treasury, *Report to the Congress on the Taxation of Life Insurance Company Products* (Mar. 1990) 2
H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. (1996) 14
Staff of the Joint Comm. on Taxation, 104th Cong., 2d Sess., *Description of Revenue Provisions Contained in the President's Fiscal Year 1997 Budget Proposal* (Comm. Print 1996) 14

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-6a) is reported at 254 F.3d 1313. The opinion of the Tax Court (Pet. App. 7a-63a) is reported at 113 T.C. 254.

JURISDICTION

The judgment of the court of appeals was entered on June 28, 2001. The petition for rehearing was denied on September 28, 2001 (Pet. App. 64a-65a). On December 10, 2001, Justice Kennedy extended the time within which to file a petition for a writ of certiorari to and including January 10, 2002, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Winn-Dixie Stores, Inc., is a major food retailer based in Jacksonville, Florida.[1] During the time period relevant to this case (1993), petitioner had 1165 stores located in 14 States and the Bahamas and had approximately 36,000 full-time employees. Pet. App. 7a-8a.

2. Corporate-owned life insurance (COLI) is life insurance purchased by a corporate employer to insure the life of one or more employees. The employer ordinarily owns the policy, pays the premiums and is the policy beneficiary. Such policies traditionally were written to protect a corporation from financial loss resulting from the death of a key person. In 1986, Congress disallowed any interest deduction attributable to a loan in excess of $50,000 made in connection with a COLI policy. 26 U.S.C. 264(a)(4) (1994). Following enactment of that provision, a new type of COLI product—known as "broad-based" COLI—evolved. Dep't of Treas. *Report to the Congress on the Taxation of Life Insurance Company Products* 14 (Mar. 1990). Under a "broad-based" COLI program, corporations purchase policies on the lives of numerous or all of the employees of a corporate policyholder. *Ibid.*

In 1993, promoters of a broad-based COLI program approached petitioner about participating in such a program by purchasing life insurance policies on the lives of its 36,000 full time employees. Pet. App. 9a. Petitioner was to be the sole owner and beneficiary of the policies. *Id.* at 10a, 21a, 30a. Because the annual

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[1] Winn-Dixie Stores, Inc., and its subsidiaries filed a consolidated return. They are referred to collectively herein as "petitioner."

premium was set at $3000 per employee, the policy coverage amounts varied with age: relatively high amounts of coverage were obtained on young employees and relatively low amounts were obtained on older employees. *Id.* at 27a, 30a. The policies were to remain in effect even after an individual left petitioner's employment, and this was a significant feature of the broad-based COLI plan since petitioner had a high employee turnover rate. *Id.* at 33a, 54a.

Memoranda from the promoters that described the program explained that petitioner would: (i) "make[ ] deposits" and pay loan interest to the insurance carrier, (ii) receive withdrawals, loans, and death proceeds from the insurance carrier and (iii) receive a tax deduction for loan interest. Pet. App. 10a. The memoranda also explained that "[a] COLI Pool generally works best when the interest rate on policy loans is highest." *Id.* at 16a. Since the interest paid, less a small fixed charge for the insurance carrier, was credited to the cash values of the policies, the use of a high interest rate had no adverse economic impact on petitioner. *Id.* at 16a, 45a.

The projections provided by the promoters to demonstrate the operation of the program showed that there would be a negative earnings and negative cash flow effect before taxes for *each* of the 60 years covered by the projections (1993 through 2052) and that there would thus be a cumulative pre-tax loss. Pet. App. 16a-24a. While the cumulative pre-tax loss was estimated to be in excess of $680 million, the projections also showed a tax savings of nearly $2.7 billion resulting from the deduction of policy loan interest and administrative fees of the program. The promoters' projections thus revealed an after-tax "profit" in excess of $2 billion from the program. *Id.* at 23a.

Recognizing that the COLI program was a tax shelter, petitioner was concerned with how it could unravel the program if the asserted tax benefits were disallowed. Pet. App. 54a. The memoranda explaining the program cautioned that "[a] COLI Pool can become a financial burden if the tax arbitrage in the program loses its attractiveness," and the promoters therefore recommended "exit strategies" that could be pursued by petitioner in that event. *Id.* at 13a.

Petitioner participated in the COLI program from 1993 through 1996. Pet. App. 35a-36a. In 1996, however, Congress enacted the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 501, 110 Stat. 2090-2093. That statute amended 26 U.S.C. 264 (1994 & Supp. V 1999) to expand the situations in which that provision expressly disallows the deduction of interest on policy loans. Petitioner decided at that time to terminate its participation in the COLI program and immediately began to implement exit strategies from that program. Pet. App. 36a-39a.

3. On its income tax return for the fiscal year ending June 30, 1993, petitioner claimed deductions of $3,735,544 for accrued policy loan interest and $100,000 for administrative fees with respect to its COLI program. Pet. App. 39a-40a. On audit, the Internal Revenue Service determined that petitioner's COLI program was tax motivated, unsupported by any business purpose independent of taxes, and lacked economic substance. The Service therefore disallowed the deductions claimed with respect to the program and issued a notice of deficiency in petitioner's income taxes. *Id.* at 40a. Petitioner brought this action in the Tax Court to challenge the deficiency determination.

Following a trial of disputed facts, the Tax Court sustained the deficiency determined by the Commissioner.

Pet. App. 62a. The court found that "no nontax purpose was served by the COLI transactions" (*id.* at 56a) and that "the only function of the plan was to produce tax deductions in order to reduce petitioner's income tax liabilities." *Id.* at 50a. The court noted that petitioner's "purchase of COLI on the lives of approximately 36,000 of its employees was done pursuant to an overall plan that projected costs and benefits for each year over a 60-year period." *Id.* at 44a. The plan was "complex and depended upon [the] relationships between many factors, including * * * rates of interest to be charged and credited * * * ." *Id.* at 45a. The plan "assumed a high rate of interest (11.06 percent) would be charged to petitioner on its policy loans" and that the high interest charge would be countered by crediting a high rate of interest (10.66 percent) "on the portion of the gross cash surrender value that petitioner had borrowed against." *Ibid.* The court noted that the "projections prepared before the actual purchase of the policies in June 1993 show that the pretax effect on petitioner for each policy year was a loss and that the after-tax effect was a significant profit." *Id.* at 46a. The court concluded that the transactions lacked economic substance because, "[w]ithout the tax deductions, the plan as designed would produce a negative cash-flow and a negative earnings effect for petitioner in each and every year the plan was in effect." *Id.* at 50a.

The court rejected petitioner's claim that it had "an economic objective and valid business purposes for entering into the COLI transaction other than tax avoidance." Pet. App. 51a. The court found no basis for petitioner's claim that it purchased the COLI policies to fund employee benefits, for no contemporaneous documents corroborate that claim and other evidence

clearly rebutted it. *Id.* at 51a-53a. The court emphasized that (*id.* at 53a (emphasis added; footnote omitted)):

> Even if we were to accept [the] testimony [of petitioner's financial officer] that he intended to use tax savings to fund Winn-Flex, that would not cause the COLI plan to have economic substance. If this were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, every sham tax-shelter device might succeed. Petitioner's benefit from the COLI plan was dependent on the projected interest and fee deductions that would offset income from petitioner's normal operations. The possibility that such tax benefits could have been used as a general source of funds for petitioner's Winn-Flex obligations (or any other business purpose) does not alter the fact that *the COLI plan itself had only one function and that was to generate tax deductions* which were to be used to offset income from its business *and thereby reduce petitioner's income tax liabilities in each year.*

The court also noted that "none of petitioner's purported business purposes affected its decision to terminate the COLI program" after the 1996 legislation "specifically prohibited the deduction of policy loan interest under petitioner's plan." *Id.* at 55a.

The Tax Court also rejected petitioner's argument that "lack of economic substance does not warrant disallowing the interest deduction in question because deductions for interest on life insurance policy loans were condoned by Congress" under 26 U.S.C. 264 (1994 & Supp. V 1999). Pet. App. 57a. The court stated that "[a] taxpayer's right to a deduction for interest on an

insurance policy loan is based on section 163, not section 264." *Id.* at 59a. The court explained that "Section 264 does not confer the right to a deduction but simply denies, disallows, or prohibits deductions that might otherwise be allowable under some other provision." *Ibid.* The court also noted that the arguments raised by petitioner under Section 264 were rejected in *Knetsch* v. *United States*, 364 U.S. 361 (1960), and *McLane* v. *Commissioner*, 46 T.C. 140 (1966), aff'd, 377 F.2d 557 (9th Cir. 1967), cert. denied, 389 U.S. 1038 (1968). Pet. App. 60a. The court emphasized that "nothing in the more recent legislative history of section 264 suggest[s] that Congress intended to allow deductions arising from sham transactions that lacked economic substance and business purpose." *Id.* 61a-62a.

3. The court of appeals affirmed in a brief opinion. Pet. App. 1a-6a. Petitioner did not challenge any of the Tax Court's findings of historical fact. *Id.* at 3a, 5a n.2. Instead, petitioner argued that the sham transaction doctrine could not be applied in this case because "Congress, through the Internal Revenue Code, explicitly authorized the deduction of interest and fees incurred in certain borrowing against whole life-insurance policies' account value." *Id.* at 3a. In rejecting that contention, the court of appeals pointed out that this Court in *Knetsch* v. *United States*, 364 U.S. at 363, "was faced with a materially similar argument decades ago by a taxpayer who sought to deduct interest payments on loans taken against an annuity contract." *Ibid.* In *Knetsch* "the annuity contract was obviously being used as a tax shelter, and as used offered the taxpayer no financial benefit other than its tax consequences," and this Court therefore "held that the indebtedness was not bona fide, and the interest not deductible under § 163(a)." *Ibid.* The court of appeals noted that, "[a]long

the way, the Court rejected an argument based on § 264 that is at least a cousin of [petitioner's] present contention," for the taxpayer in *Knetsch* "argued that Congress's failure to close a loophole in § 264 (that section's prohibition of deductions on indebtedness to purchase life-insurance policies did not extend to annuities until 1954, the year after the tax year in question) equated to blessing the loophole." *Ibid.* In *Knetsch*, "[t]he Court declined to attribute such an intention to Congress, because that would 'exalt artifice above reality.'" *Ibid.* (quoting 364 U.S. at 367). The court of appeals noted that, in *Knetsch*, this Court held "that the sham-transaction doctrine does apply to indebtedness that generates interest sought to be deducted under § 163(a), even if the interest deduction is not yet prohibited by § 264." Pet. App. 4a. The court concluded that the reasoning applied in *Knetsch* governs here as well. *Id.* at 5a.

In rejecting petitioner's further argument that the Tax Court had misapplied the sham transaction doctrine, the court of appeals observed that, while this "doctrine has few bright lines," it is nonetheless "clear that transactions whose sole function is to produce tax deductions are substantive shams." Pet. App. 5a. The court concluded that the Tax Court did not misapply the sham transaction doctrine in holding that the "broad-based COLI program had no 'function' other than generating interest deductions." *Ibid.* Moreover, the court of appeals pointed out that petitioner had not challenged the findings of the Tax Court that the COLI program could not generate a pretax profit and did not serve any business purpose. *Id.* at 5a-6a & n.2. Based on these unchallenged findings, the court of appeals concluded that petitioner's "broad-based COLI pro-

gram lacked sufficient economic substance to be respected for tax purposes." *Id.* at 6a.

ARGUMENT

The factual determination of the courts below that petitioner's COLI program had no economic function other than generating tax deductions has ample support in the record. The holding of the court of appeals that the claimed deductions are therefore not allowable correctly applies the decisions of this Court and does not conflict with the decision of any other court of appeals. Further review is therefore not warranted.

1. Section 163(a) of the Internal Revenue Code provides that "[t]here shall be allowed as a deduction all interest paid or accrued within the taxable year on *indebtedness*." 26 U.S.C. 163(a) (emphasis added). In *Knetsch* v. *United States*, 364 U.S. 361 (1960), the Court disallowed interest deductions arising from what the taxpayer claimed was "indebtedness" owed to an insurance company. The taxpayer in *Knetsch* had purchased "annuity savings bonds" from an insurance company, had taken "loans" secured by those bonds that equaled almost their entire cash value, and had then claimed a deduction for the "interest" on the purported loans. The Court examined the transaction between the taxpayer and the insurance company and determined that it did not create "interest * * * on indebtedness" within the meaning of Section 163(a). 364 U.S. at 365-366. The Court noted that, "[i]n form, [the taxpayer] had an annuity contract with a so-called guaranteed cash value at maturity of $8,388,000, which would produce monthly annuity payments of $90,171, or substantial life insurance proceeds in the event of his death before maturity." *Id.* at 365. The Court held, however, that this form was "a fiction" because the annual

borrowings kept the net cash value "at the relative pittance of $1,000" and the transaction therefore "did not appreciably affect [the taxpayer's] beneficial interest except to reduce his tax." *Id.* at 366 (internal quotation marks omitted). The Court concluded that the taxpayer realized "nothing of substance * * * from this transaction beyond a tax deduction." *Ibid.* The Court held that such an arrangement is a "sham" and does not create "indebtedness" that could generate deductible interest under Section 163(a).[2] *Ibid.*

The Court in *Knetsch* also rejected the taxpayer's argument that "Congress in enacting § 264 of the 1954 Code authorized * * * deductions" for sham transactions that had been entered into prior to the enactment of that statute. 364 U.S. at 367. The taxpayer "attribute[d] to Congress a purpose to allow the deduction of pre-1954 payments under transactions of the kind carried on by [him] with the insurance company without regard to whether the transactions created a true obligation to pay interest." *Ibid.* The Court concluded, however, that "[u]nless that meaning plainly appears we will not attribute it to Congress. 'To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.'" *Ibid.* (quoting *Gregory* v. *Helvering*, 293 U.S. 465, 470 (1935)). The Court found no evidence in "the statute and materials relevant to its

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[2] Petitioner erroneously states (Pet. 10-11) that "the IRS conceded * * * the deductions at issue here satisfied the terms [of] * * * Section 163(a)." The government argued below that, "[t]o be allowable as a deduction under [Section 163(a)], interest must be incurred in connection with an 'indebtedness' and the case law makes it plain that there is no 'indebtedness' within the meaning of § 163 if the transaction giving rise to the asserted indebtedness does not have nontax substance." Gov't. C.A. Br. 28.

construction * * * that Congress meant in § 264(a)(2) to authorize the deduction of payments made under sham transactions entered into before 1954." 364 U.S. at 369. The Court noted, moreover, that the text of Section 264 "itself negates any suggestion that sham transactions were the congressional concern, for the deduction denied is of certain interest payments on actual 'indebtedness.'" *Ibid.* The Court concluded that Section 264 does not alter the established meaning of the term "indebtedness" as used in that Section and in Section 163(a). *Ibid.*

2. Following this Court's decision in *Knetsch*, the courts of appeals have consistently held that transactions that constitute economic shams do not create "indebtedness" and therefore do not give rise to interest deductions under Section 163(a). *Lee* v. *Commissioner*, 155 F.3d 584, 586 (2d Cir. 1998); *United States* v. *Wexler*, 31 F.3d 117, 122-123 (3d Cir. 1994), cert. denied, 513 U.S. 1190 (1995); *Shirar* v. *Commissioner*, 916 F.2d 1414, 1417 (9th Cir. 1990); *Salley* v. *Commissioner*, 464 F.2d 479, 483 (5th Cir. 1972); *Golsen* v. *Commissioner*, 445 F.2d 985, 988 (10th Cir.), cert. denied, 404 U.S. 940 (1971). For the same reasons, the courts have also uniformly held that such transactions do not create "ordinary and necessary expenses * * * incurred * * * in carrying on any trade or business" within the meaning of 26 U.S.C. 162(a) (1994 & Supp. V 1999). *Pasternak* v. *Commissioner*, 990 F.2d 893, 896-897 (6th Cir. 1993); *Karr* v. *Commissioner*, 924 F.2d 1018, 1022-1023 (11th Cir. 1991), cert. denied, 502 U.S. 1082 (1992); *Salley* v. *Commissioner*, 464 F.2d at 483. The court of appeals correctly applied these established principles in holding in this case that "a transaction is not entitled to tax respect if it lacks economic effects or substance

other than the generation of tax benefits, or if the transaction serves no business purpose." Pet. App. 5a.

Petitioner's COLI program was consciously designed to produce a purported loss of more than $680 million before taxes were taken into account. Through massive amounts of contrived loan interest expense deductions claimed under Section 163(a), however, the program was supposed to generate tax savings of approximately $2.7 billion and thereby yield a post-tax benefit in excess of $2 billion—all at the expense of other taxpayers and the public fisc. Based on these unchallenged facts, and on the absence of any credible evidence that petitioner had any non-tax business purpose for its participation in the program, the Tax Court properly found that the plan had no economic substance, no business purpose, and no function other than to produce tax deductions. Pet. App. 50a, 62a. Here, as in *Knetsch*, "there was nothing of substance to be realized * * * beyond a tax deduction." 364 U.S. at 366.

Petitioners did not demonstrate that there was any clear error in these findings and, indeed, did not even "challenge the tax court's fact findings" on appeal. Pet. App. 5a n.2. The court of appeals therefore properly upheld the decision below, which "properly examined the transaction under the sham-transaction doctrine." *Id.* at 5a.

3. Petitioner errs in asserting (Pet. 10-14) that the plain text of Section 264 of the Internal Revenue Code authorizes the interest expense deductions at issue in this case. Section 163(a) allows an interest expense deduction only with respect to interest paid on bona fide "indebtedness." 26 U.S.C. 163(a). As this Court held in *Knetsch*, 364 U.S. at 364-365, that section does not allow deductions for sham transactions. And, contrary to petitioner's claim, Section 264 does not author-

ize a deduction for interest expense that is not allowable under Section 163(a). Instead, Section 264 specifies that "[n]o deduction shall be allowed for" various types of claimed expenses even if those expenses *could* qualify as ordinary and necessary business expenses under Section 162 or as interest expenses under Section 163. See 26 U.S.C. 264(a)(1)-(4) (1994 & Supp. V 1999). As the Tax Court correctly explained, "Section 264 does not confer the right to a deduction but simply denies, disallows, or prohibits deductions that might otherwise be allowable under some other provision." Pet. App. 59a. See also *Weller* v. *Commissioner*, 270 F.2d 294, 298 (3d Cir. 1959), cert. denied, 364 U.S. 908 (1960) (this provision "does not even purport to indicate what items are deductible"); *Golsen* v. *Commissioner*, 54 T.C. 742, 756 (1970), aff'd, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971).[3]

The legislative history of the Health Insurance Portability and Accountability Act of 1996 demonstrates that Congress did not view Section 264 as authorizing deductions for sham COLI transactions entered into prior to 1996.[4] The Conference report for the 1996 Act noted: (i) the categorical rule in Section 264(a)(4) that disallows interest expense deductions when the amount of debt on an individual policy exceeds $50,000; (ii) the rule in Section 264(a)(3) that disallows policy loan interest deductions for systematic borrowing; and

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[3] Petitioner also erroneously relies on Section 7702 of the Code. Pet. 13. That Section does not allow a tax deduction; it simply provides a definition of a "life insurance contract" for purposes of the Internal Revenue Code. 26 U.S.C. 7702.

[4] This legislative history refutes petitioner's assertion (Pet. 14) that "[t]he only conceivable explanation" for the portions of Section 264 upon which petitioner relies is that "Congress consciously chose to authorize the use of leverage in COLI-like transactions."

(iii) the exception in Section 264(c)(1) to the rule in Section 264(a)(3) when four out of the first seven annual premiums are not paid through borrowing. H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. 319-320 (1996). The Report explained that, even when these categorical rules are satisfied, the transaction must still "give[] rise to debt, for Federal income tax purposes" before an interest expense deduction would be allowed. *Ibid.* See also *id.* at 320 n.23 ("[i]n addition to the specific disallowance rules of section 264, generally applicable principles of tax law apply").[5] Congress thus clearly understood that taxpayers who claim interest expense deductions remain subject to the holding in *Knetsch* that an interest deduction is not allowed if the transaction that generates it is an economic sham.

4. Petitioner contends (Pet. 14-21) that the decision of the court of appeals creates a conflict among the circuits over whether the sham transaction doctrine is a threshold inquiry that applies apart from the language of any particular Code provision. Contrary to petitioner's assertion, however, the court of appeals did not hold that the sham transaction doctrine applies independent of the Code or state that a particular Code sec-

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[5] The Joint Committee explanation of this provision emphasizes that (Staff of the Joint Comm. on Taxation, 104th Cong., 2d Sess., *Description of Revenue Provisions Contained in the President's Fiscal Year 1997 Budget Proposal* 80, 82 (Comm. Print 1996) (emphasis added):

> [t]he proposal would not affect the determination of whether interest is deductible under present-law rules (including whether interest paid or accrued during the phase-in period is otherwise deductible), and the ***IRS would not be precluded from applying common-law doctrines or statutory or other tax rules to challenge corporate-owned life insurance plans to which present-law rules apply.***

tion could not displace it. Instead, the court of appeals correctly followed this Court's decision in *Knetsch* in holding (i) that an economic sham cannot qualify as "indebtedness" within the meaning of Section 163(a) and (ii) that Section 264 has no application when, as here, the transaction does not constitute "indebtedness" under Section 163(a). Pet. App. 5a. See pages 7-8, *supra*.[6]

Nothing has transpired since this Court's decision in *Knetsch* to cast doubt on the continuing validity of that decision. The language of Section 163(a) remains unchanged, and Section 264 is still only a disallowance provision. Nothing makes it "plainly appear[ ]" that Congress intended to exalt artifice above reality or authorize interest expense deductions for sham transactions under Section 163(a). *Knetsch* v. *United States*, 364 U.S. at 367. Following *Knetsch*, courts have consistently rejected the contentions based on the text of Section 264 that have been raised by petitioner and other taxpayers. See *In re CM Holdings, Inc.*, 254 B.R. 578, 599-600, 624 (D. Del. 2000), appeal pending, No. 00-3875 (3d Cir.); *Young* v. *Commissioner*, 70 T.C.M. (CCH) 357, 360 (1995); *Golsen* v. *Commissioner*, 54 T.C. at

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[6] Because the court of appeals did not hold the sham transaction doctrine applies independent of the Code, petitioners' contention (Pet. 18-21) that the decision in this case conflicts with *Horn* v. *Commissioner*, 968 F.2d 1229 (D.C. Cir. 1992), is unavailing. Petitioners similarly miss the mark in contending that there is a "close similarity" (Pet. 20) between the situation in *Horn* and that in the present case. The statute at issue in *Horn* provided that a particular type of loss "shall be allowed." 968 F.2d at 1233-1234. Section 264, by contrast, does not purport to *allow* any deduction. Instead, its plain language *denies* a deduction that might otherwise exist, for it states that "[n]o deduction shall be allowed" under the categorical circumstances that it describes. 26 U.S.C. 264(a) (1994 & Supp. V 1999).

755-756; *Pierce* v. *Commissioner*, 28 T.C.M. (CCH) 1, 7 (1969); *McLane* v. *Commissioner*, 46 T.C. 140, 143 (1966), aff'd, 377 F.2d 557 (9th Cir. 1967), cert. denied, 389 U.S. 1038 (1968). See also *Salley* v. *Commissioner*, 464 F.2d at 485-486 n.9.

5. There is also no merit to petitioner's contention (Pet. 23) that the decision of the court of appeals conflicts with *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978). The court of appeals held that, in light of *Knetsch*, the Tax Court properly examined the transaction at issue under the sham transaction doctrine and properly applied that doctrine in holding that "transactions whose sole function is to produce tax deductions are substantive shams." Pet. App. 5a. As the court concluded a transaction that has "no 'function' other than generating interest deductions" is an economic sham and is to be disregarded under *Knetsch*. *Ibid.*[7]

Nothing in *Frank Lyon* alters or conflicts with the economic sham doctrine of *Knetsch*. In the *Frank Lyon* case, the Court addressed a sale and leaseback transaction that was in a form compelled by regulatory requirements. 435 U.S. at 575. To assess "the sub-

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[7] Petitioner's contention (Pet. 26-27) that its COLI program had meaningful non-tax economic benefits is belied by the fact that it dropped the program immediately after Congress in 1996 enacted legislation effectively curtailing policy loan interest deductions for COLI programs. Pet. App. 55a. The courts below could properly infer that if the program "appreciably affect[ed] [petitioner's] beneficial interest except to reduce [its] tax" (*Knetsch*, 364 U.S. at 366), petitioner would have continued in the program after the 1996 legislation. Moreover, the Tax Court found that petitioner's contention (Pet. 26) that it might benefit by receiving massive amounts of death benefits was "improbable," "unrealistic" and therefore "had no economic significance." Pet. App. 49a. That finding is fully supported by expert actuarial testimony (5/6/98 Tr. 934-935) (Dkt. entry 114) and other evidence in the record.

stance and economic realities of the transaction" before it, the Court looked to a multitude of facts, including the fact that "diversification was Lyon's principal motivation" in engaging in the transaction. *Id.* at 582. The Court held that "where, as here, there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor" the transaction. *Id.* at 583-584. In reaching that conclusion, however, the Court "emphasize[d] that we are not condoning manipulation by a taxpayer through arbitrary labels and dealings that have no economic significance." *Id.* at 583. When the court of appeals declined in the present case to sanction a transaction that had no function or purpose other than to generate interest deductions, it thus followed the holdings of the *Frank Lyon* case, as well as *Knetsch.*

Petitioner errs in arguing (Pet. 23-28) that *Maysteel Products, Inc.* v. *Commissioner*, 287 F.2d 429 (7th Cir. 1961), *Fabreeka Products Co.* v. *Commissioner*, 294 F.2d 876 (1st Cir. 1961), and *Sacks* v. *Commissioner*, 69 F.3d 982 (9th Cir. 1995), conflict with the decision of the court of appeals. None of those cases involves a COLI program or an interest deduction claimed under Section 163(a). Moreover, in none of those cases did the court find that the transaction involved had no function other than to generate a tax deduction. Both *Maysteel* and *Fabreeka* involved bond transactions that *had* non-tax economic significance. 287 F.2d at 431 ("[s]ubstantive and economic reality were present"); 294 F.2d at 878 ("the taxpayers made actual 'investments' in the ordinary sense of the word"). And, in *Sacks*, the court

overturned the disallowance of depreciation deductions and investment credit claimed in connection with a sale-and-leaseback of solar water heaters because it held that the transaction was not a sham. The court explained that its "sham analysis" looked to "whether the transaction had any practical economic effects other than the creation of income tax [savings]." 69 F.3d at 988. Nothing in these decisions conflicts with the analysis or the conclusion of the court of appeals in the present case.[8]

6. The Eleventh Circuit has stated that its view of the sham transaction doctrine differs from "the oft-used statement of the doctrine derived from *Rice's Toyota World, Inc. v. Comm'r*, 752 F.2d 89, 91-92 (4th Cir. 1985)" in that the court would disregard a transaction "if it has no business purpose and its motive is tax avoidance." *UPS* v. *Commissioner*, 254 F.3d 1014, 1018 & n.2 (11th Cir. 2001). Petitioner asserts (Pet. 22-28) that this difference in description of the sham transaction doctrine warrants this Court's review. But petitioner cites no decision of any circuit in which the sham transaction doctrine was invoked for a transaction that had economic substance but lacked any business purpose. Indeed, the court of appeals in *UPS* explained

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[8] See also *ACM Partnership* v. *Commissioner*, 157 F.3d 231, 257 n.49 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999) (distinguishing the sale and leaseback transaction involved in *Sacks* from a contingent installment sale exchange that served no non-tax business purpose and did not materially alter the taxpayer's economic position).

that it did not use a narrow concept of "business purpose." 254 F.3d at 1019. The court stated that under its view (*ibid.*):

> A "business purpose" does not mean a reason for a transaction that is free of tax considerations. Rather, a transaction has a "business purpose," when we are talking about a going concern like UPS, as long as it figures in a bona fide, profit-seeking business.

A transaction that has economic substance would thus typically represent "a bona fide, profit-seeking business" under the Eleventh Circuit's articulation of the sham transaction doctrine.

Certainly no distinction in the application of this standard would occur in the present case. The Tax Court found that the only purpose of petitioner's broad-based COLI program was to generate tax deductions and further found that the program lacked *both* economic substance and a business purpose. Pet. App. 49a-57a, 62a. In affirming, the court of appeals agreed that the program's only function was to generate tax deductions and concluded that the program "lacked sufficient economic substance to be respected for tax purposes." *Id.* at 6a. Further review of these factual determinations "concurred in by two lower courts" (*Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982)) is not warranted. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985). And, on these findings, the courts below were correct in holding, under any formulation of the sham transaction doctrine, that the claimed deduction must be disallowed.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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